Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1996

BURLINGTON RESOURCES OIL & GAS COMPANY,

Petitioner,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

RICHARD M. BLUMBERG
Associate General Counsel
BURLINGTON RESOURCES
OIL & GAS COMPANY
5051 Westheimer
Suite 1400
Houston, Texas 77056
(713) 624-9270

KIM M. CLARK
Counsel of Record
JOHN, HENGERER
& ESPOSITO
1200 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 429-8800

Attorneys for Petitioner

70391-B
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21
Lutz Appellate Services, inc.

39 pp

QUESTION PRESENTED

Whether under the service continuity provisions of Section 7(b) of the Natural Gas Act, 15 U.S.C. § 717f(b), it is an exercise of market and/or monopoly power for an interstate natural gas pipeline company to terminate transportation service unless an existing shipper pays the maximum agency-set rate, even though a lower competitive rate for such service has been established pursuant to an agency dictated right of first refusal bidding procedure.

PARTIES TO THE PROCEEDINGS BELOW

Federal Energy Regulatory Commission (Respondent)

Alabama Gas Corporation (Intervenor)

Algonquin Gas Transmission Company (Intervenor)

Allied Signal Inc. (Intervenor)

American Forest & Paper Association (Petitioner)

American Public Gas Association (Petitioner)

Amoco Production Company (Intervenor)

Anadarko Petroleum Corporation (Intervenor)

ANR Pipeline Company (Intervenor)

Arcadian Fertilizer (Petitioner)

Arco Natural Gas Marketing (Intervenor)

Arco Oil & Gas Company (Intervenor)

Arizona Electric Power Cooperative Inc. (Petitioner)

Arizona Public Service Company, *et al.* (Petitioner)

Asarco, Inc., Cyprus Miami Mining Corporation, and Magma Copper Company (Petitioner)

Associated Gas Distributors (Petitioner)

Associated Natural Gas Company (Petitioner)

Atlanta Gas Light Company (Petitioner)

Baltimore Gas & Electric Company (Petitioner)

Bay State Gas Company, *et al.* (Intervenor)

Board of Water, Gas & Light Commissioners, Albany, Georgia (Intervenor)

Brooklyn Union Gas Company (Intervenor)

Canadian Association of Petroleum Producers, *et al.* (Intervenor)

Carnegie Natural Gas Company (Petitioner)

Chattanooga Gas Company (Petitioner)

Cascade Natural Gas Corporation (Intervenor)

Chevron, U.S.A., Inc. (Intervenor)

Cincinnati Gas & Electric Company, *et al.* (Intervenor)

Citizens Gas & Coke Utility (Petitioner)

City of Hamilton, Ohio (Petitioner)

CNG Transmission Corporation (Petitioner)

Colorado Interstate Gas Company (Petitioner)

Colorado Springs Utilities (Petitioner)

Columbia Gas Distribution Companies (Intervenor)

Columbia Gas Transmission Corporation (Intervenor)

Conoco, Inc. (Intervenor)

Consolidated Edison Company of New York, Inc. (Petitioner)

Dakota Gasification Company (Intervenor)

Dayton Power & Light Company (Intervenor)

Destec Energy, Inc. (Intervenor)

East Ohio Gas Company, *et al.* (Intervenor)

East Tennessee Group (Petitioner)

East Tennessee Natural Gas Company (Intervenor)

Elizabethtown Gas Company, an Operating Division of NUI Corporation (Petitioner)

El Paso Natural Gas Company (Intervenor)

Enron Oil & Gas Marketing, Inc. (Intervenor)

Enserch Development Corporation (Petitioner)

Equitrans, Inc. (Petitioner)

Exxon Corporation (Intervenor)

Florida Cities (Intervenor)

Florida Gas Transmission Co. (Intervenor)

Foothills Pipelines Ltd. (Intervenor)

Fort Pierce Utilities Authority and the City of Vero Beach, Florida (Intervenor)

Fuel Managers Association (Intervenor)

Georgia Industrial Group (Petitioner)

Great Lakes Transmission Ltd. (Intervenor)

Hadson Gas Systems, Inc. (Petitioner)

Illinois Commerce Commission (Petitioner)

Illinois Power Company (Petitioner)

Indiana Gas Company (Petitioner)

Interstate Natural Gas Association of America (Intervenor)

Joint State Commissions and Consumer Advocates (Petitioner)

KN Energy, Inc. (Intervenor)

Kern River Gas Transmission Company (Petitioner)

Koch Gateway Pipeline Company (Petitioner)

Laclede Gas Company (Petitioner)

Long Island Lighting Company (Petitioner)

Louisville Gas & Electric Company (Petitioner)

Maryland Office of People's Counsel (Petitioner)

Maxus Exploration Company and Maxus Gas Marketing Company (Intervenor)

Memphis Light, Gas and Water Division (Petitioner)

Meridian Oil Inc. (Petitioner)

Michigan Consolidated Gas Company (Intervenor)

Midland Cogeneration Venture Limited (Petitioner)

Minnesota Public Utility Commission and Minnesota Department of Public Service (Intervenor)

Mississippi River Transmission Corporation (Intervenor)

Missouri and Kansas Gas Users (Intervenor)

Missouri Public Service Commission, *et al.* (Petitioner)

Mitchell Energy Corporation (Intervenor)

Mobile Gas Service Corporation, *et al.* (Intervenor)

Mobile Natural Gas, Inc. (Intervenor)

Montana Public Service Commission, Public Utilities Commission of South Dakota and Montana Consumer Counsel (Petitioner)

Mountaineer Gas Company (Petitioner)

National Association of State Utility Consumer Advocates (Petitioner)

National Association of Gas Consumers (Intervenor)

National Fuel Gas Supply Corporation (Intervenor)

Natural Gas Clearinghouse (Intervenor)

Natural Gas Pipeline Company of America (Intervenor)

New Jersey Board of Regulatory Commissioners (Petitioner)

New Jersey Natural Gas Company (Petitioner)

New York State Electric & Gas Corporation

New England Power Company (Petitioner)

Northern Indiana Public Service Company (Petitioner)

Niagara Mohawk Power Corporation (Petitioner)

NorAm Energy Corporation (Petitioner)

North Carolina Natural Gas Company and Public Service Commission of North Carolina (Intervenor)

Northeast Energy Associates and New Jersey Energy Associates (Intervenor)

Northern Border Pipeline Company (Intervenor)

Northern Distributor Group (Intervenor)

Northern States Power Company (Minn.), *et al.* (Intervenor)

Northern Natural Gas Company, *et al* (Intervenor)

Northwest Alaskan Pipeline Company (Petitioner)

Ocean State Power, *et al.* (Petitioner)

Office of the Consumers' Counsel, State of Ohio (Petitioner)

Orange and Rockland Utilities, Inc. (Petitioner)

Ozark Gas Transmission System (Petitioner)

Pacific Gas & Electric Company (Petitioner)

Pacific Interstate Transmission Company, *et al.* (Intervenor)

Pan-Alberta Gas, Ltd. (Intervenor)

Panhandle Customer Group (Intervenor)

Panhandle Eastern Pipe Line Company (Intervenor)

Panhandle Trading Company (Intervenor)

Pennzoil Exploration & Production Company and Pennzoil Gas Marketing Company (Intervenor)

PEPCO Energy (Petitioner)

Pennsylvania Office of Consumer Advocate (Petitioner)

Pennsylvania Public Utility Commission, *et al.* (Petitioner)

Peoples Gas System, Inc. (Intervenor)

Peoples Natural Gas Company (Petitioner)

Piedmont Natural Gas Company (Petitioner)

Philadelphia Electric Company (Petitioner)

Phillips Petroleum Company, *et al.* (Intervenor)

Plains Petroleum Operating Company (Petitioner)

Process Gas Consumers Group, *et al.* (Intervenor)

Producer-Marketing Transportation Group (Petitioner)

ProGas, Ltd. (Petitioner)

Public Service Commission of the Commonwealth of Kentucky (Petitioner)

Public Service Commission of Nevada (Intervenor)

Public Service Commission of the State of New York (Petitioner)

Public Service Commission of West Virginia, Consumer Advocate Division (Petitioner)

Public Service Commission of Wisconsin (Petitioner)

Public Service Electric & Gas Company (Intervenor)

Public Utilities Commission of the State of California (Petitioner)

Rochester Gas & Electric Company (Intervenor)

Shell Gas Trading Company (Intervenor)

South Jersey Gas Company (Intervenor)

South Carolina Pipeline Corporation (Intervenor)

Southern Natural Gas Company (Intervenor)

Southwest Gas Corporation (Petitioner)

State of Louisiana (Petitioner)

State of Indiana, Office of Utility Consumer Counselor (Petitioner)

Tenneco Gas, Inc. (Intervenor)

Tennessee Gas Pipeline Company (Intervenor)

Tennessee Small General Service and Columbia Small Customer Group (Intervenor)

Tennessee Valley Municipal Gas Association (Petitioner)

Texaco, Inc. (Intervenor)

Texas Eastern Transmission Corporation, *et al.* (Intervenor)

TransCanada Pipelines Limited (Intervenor)

Transcontinental Gas Pipe Line Corporation (Intervenor)

Transwestern Pipeline Company (Intervenor)

Trunkline Gas Company (Intervenor)

T.W. Phillips Gas & Oil Company (Intervenor)

UGI Utilities, Inc. (Intervenor)

Union Pacific Fuels, Inc. (Intervenor)

United Cities Gas Company (Intervenor)

United Distribution Companies (Petitioner)

Vastar Resources, Inc. and Vaster Gas Marketing, Inc. (Intervenor)

Virginia Electric & Power Company (Petitioner)

Washington Gas Light Company (Intervenor)

Williams Gas Marketing Company (Petitioner)

Williams Natural Gas Company (Petitioner)

Williston Basin Interstate Pipeline Company (Petitioner)

Windward Energy and Marketing Company (Intervenor)

Wisconsin Distributor Group (Petitioner)

PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES

Burlington Resources Oil & Gas Company, successor to Meridian Oil Inc., is a Delaware corporation with its principal place of business in Houston, Texas. Burlington Resources Oil & Gas Company is a wholly owned subsidiary of Burlington Resources Inc. Burlington Resources Oil & Gas Company has no nonwholly owned subsidiaries.

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Secondary Market Transactions on Interstate Natural Gas Pipelines, 77 FERC ¶ 61,183 (1996) 11

Burlington Resources Oil & Gas Company (Burlington Resources)[1] (hereinafter "Petitioner") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at *United Distribution Companies, et al. v. Federal Energy Regulatory Commission*, 88 F.3d 1105 (D.C. Cir. 1996). Pet. App. 1a-174a.[2] The Federal Energy Regulatory Commission's (FERC or Commission) decisions reviewed by the court are reported at Order No. 636 (Pet. App. 175a-407a); the Commission's orders on rehearing are reported at Order No. 636-A (Pet. App. 408a-812a) and Order No. 636-B (Pet. App. 813a-1002a).

STATEMENT OF JURISDICTION

The judgment of the court of appeals was entered on July 16, 1996. Timely petitions for rehearing and rehearing *en banc* were denied on October 29, 1996. Pet. App. 1003a-1006a. The jurisdiction of the Court is invoked pursuant to 28 U.S.C. § 1254(1) (1994) and 15 U.S.C. § 717r(b) (1994).

STATUTE INVOLVED

Section 7(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717f(b) (1994), provides in pertinent part that:

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1. Burlington Resources is the successor — by virtue of a name change effective July 11, 1996 — to Meridian Oil Inc. (Meridian), which was a petitioner in the proceeding below. For purposes of continuity, the Burlington Resources name has been substituted for Meridian where that name was used in the proceedings below.

2. The several petitioners from the decision below are submitting a joint appendix. All references herein to the appendix are to that joint appendix.

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

STATEMENT OF THE CASE

This case presents an important new issue of administrative law which should be decided by the Supreme Court. That issue is whether it is lawful to force an existing utility customer to pay the maximum rate set by a regulatory agency for continued service, even though competitive forces which the agency stated would control and protect the customer's access to service establish a lower (and otherwise lawful) market value for the subject service.

The context of this question is the service continuity protections in Section 7(b) of the NGA (Pet. App. 1020a), which prevent an interstate natural gas pipeline company (pipeline) from terminating an existing transportation service without prior permission from FERC. As part of the Commission's Order Nos. 636, *et al.* rulemaking, a pipeline was given advance (*i.e.*, pregranted abandonment) authority to stop service to an existing customer, unless the customer matched the highest rate and best terms offered by another party. However, if the highest rate bid and then matched by the existing shipper was less than the maximum permissible rate, FERC allowed the pipeline to

terminate the existing service unless the existing shipper agreed to pay that rate.

The court below upheld FERC, finding — without citation to any precedent — that the NGA protects a customer's right to continued transportation service only if the customer pays the maximum rate. The NGA, however, was intended by Congress, and has been interpreted by this Court, to protect the rights of consumers against the monopolistic practices of natural gas pipeline utilities. But forcing a customer to pay the maximum rate or lose its service rights aids, not protects against, the exercise of market and/or monopoly power by a pipeline. This is in direct conflict with the consumer protections guaranteed by Section 7(b) of the NGA.

A. Regulatory Background

Section 7(b) of the NGA protects the right of existing shippers on interstate natural gas pipelines to retain their right to service unless and until FERC permits abandonment of such service. Abandonment may be granted in advance of the termination of the underlying contract of service (*i.e.*, pre-granted abandonment), provided the circumstances required in the statute are found to be present when the pre-granted abandonment determination is made.

In Order No. 636, FERC exercised its authority to provide for pre-granted abandonment under NGA Section 7(b) where service contracts of more than one year were due to expire. In the rulemaking, the existing shipper was able to retain its service rights by matching the highest rate and best terms offered by other interested parties. Pet. App. 312a-323a . FERC thus elected to have market forces determine which customers would have access to interstate pipeline capacity when an existing contract for firm transportation service expired. The right of first refusal

(ROFR) procedure was developed by FERC in response to the remand of an earlier unsuccessful attempt to fashion pregranted abandonment procedures. *American Gas Association v. FERC* (*AGA*), 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 498 U.S. 1084 (1991).

On rehearing of its initial order in the Order No. 636 series, FERC clarified that if the best bid was at a price less than the FERC-set maximum rate, the pipeline could decline to enter into a new or extended service agreement. Therefore, even though the existing customer had agreed to pay the highest rate bid for the service, the Commission's rule permitted the pipeline to cease service. FERC's rationale for this action was that the pipeline would not be compelled to discount its service (hereafter the no discounting rule). Pet. App. 637a.

In response to objections by Burlington Resources and others that the no discounting rule was inconsistent with FERC's assertions that market forces should allocate capacity, and with long-standing Section 7(b) protections for existing customers, FERC merely restated that pipelines would not be required to discount. Pet. App. 929a-937a. The Commission also asserted that if a pipeline failed to maximize throughput (*i.e.*, by leaving capacity unsold), there was no guarantee the pipeline would be able to recover all its costs in its next rate case. Pet. App. 936a.

B. The Decision Below

The D.C. Circuit Court (D.C. Circuit or court below) affirmed FERC's refusal, as part of the ROFR procedures, to insist that a pipeline renew the service of an existing shipper who was willing to match the highest bid for the subject capacity, if that bid was at less than the maximum rate. The court found that FERC had protected against the pipeline's exercise of market power by removing the pipeline's ability to influence the bidding,

and by limiting the maximum rate the pipeline could charge. Pet. App. 54a-55a.

The court noted that the purpose of selective discounting by a pipeline was to increase throughput by attracting volumes it might not otherwise transport. Thus, Burlington Resources'

> proposal that pipeline's be required to discount in favor of demand-inelastic, captive customers would render meaningless pipeline's ability to charge up to the maximum approved rate. The § 7(b) abandonment provisions protect customers against loss of service only if the customer is willing to pay the maximum rate approved in a rate proceeding.

Pet. App. 55a.

The court also responded to the contention that the ability of a pipeline to refuse service at less than the maximum rate prevented the ROFR mechanism from reflecting competitive market forces. The D.C. Circuit found adequate FERC's assertion that a pipeline which declined to discount its service in favor of not contracting for available capacity might not be entitled to full cost recovery in its next rate case. According to the court, this was a sufficient incentive for the pipeline to discount in appropriate circumstances. Pet. App. 55a-56a.

The D.C. Circuit denied a timely petition for rehearing and suggestions for rehearing *en banc* filed by other Petitioners with respect to another issue in the Order No. 636 rulemaking. Pet. App. 1003a-1006a.

REASONS FOR GRANTING THE WRIT

The decision below conflicts with the fundamental purpose of the Natural Gas Act, as understood and interpreted by this Court, which is to use regulation as a means to protect consumers by maintaining service continuity and by preventing pricing abuse due to the exercise of market and/or monopoly power by interstate pipelines. Contrary to these statutory standards, the court below sustained FERC's election to sacrifice the interests of pipeline customers, the persons for whom the NGA was enacted, in order to advance the revenue maximization of regulated pipelines.

FERC's no discounting rule, therefore, is inconsistent with the consumer protections in Section 7(b) of the Natural Gas Act. The best illustration of this failing is the rationale offered by the court below, which is that if the pipeline were required to accept a market-determined rate, it would be unable to force "demand-inelastic, captive customers" to pay the maximum permissible rate. It is difficult to conceive a more perverse analysis of a statutory provision which was designed to protect consumers.

FERC's no discounting rule thus results in the unusual situation whereby the regulator supports and promotes the ability of a regulated entity to exercise market and/or monopoly power to the detriment of the utility's customers. Whether that is a permissible or appropriate policy under the NGA appears to be a matter of first impression for this Court.

I.

THE COURT OF APPEALS' DECISION CONFLICTS WITH STATUTORY PROTECTIONS FOR PIPELINE CUSTOMERS.

FERC's ROFR mechanism is intended to comply with the requirements for pregranted abandonment under Section 7(b). *See, e.g., FPC v. Moss*, 424 U.S. 494 (1976). *See also Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Companies*, 498 U.S. 211 (1991). In fact, the ROFR mechanism in Order No. 636 is a direct response to the Commission's failure to comply with this requirement in an earlier rulemaking. In *AGA*, *supra*, the D.C. Circuit remanded FERC's effort at pregranted abandonment in order for the Commission to reconsider

> how pregranted abandonment trumps another basic precept of natural gas regulation — protection of gas customers from pipeline exercise of monopoly power through refusal of service at the end of a contract period.

912 F.2d at 1518.

The ROFR mechanism, however, fails to meet the service continuity and rate protection concerns inherent in Section 7(b). The court below sought to reconcile this contradiction by finding that a shipper was assured of retaining its transportation service only by paying the maximum rate. However, the D.C. Circuit did not offer a single case reference to support this proposition. Moreover, this holding directly contradicts numerous decisions of this Court to the effect that the purpose of the NGA is consumer protection, not pipeline revenue maximization.

The NGA has been determined by this Court to be a consumer-oriented statute. As noted in *FPC v. Hope Natural Gas Company*, 320 U.S. 591, 610 (1944), "[t]he primary aim of this legislation was to protect consumers against exploitation at the hands of natural gas companies."

> We cannot find in the words of the Act or in its history the slightest intimation or suggestion that the exploitation of consumers by private operators through the maintenance of high rates should be allowed to continue. . . .

Id. at 612. *See also* the Court's summary of the purpose of the NGA in *California v. Southland Royalty Company*, 436 U.S. 519, 523 (1978), "[t]he fundamental purpose of the Natural Gas Act is to assure an adequate and reliable supply of gas at reasonable prices." *See also Atlantic Refining Company v. Public Service Commission (CATCO)*, 360 U.S. 378, 388 (1959), where the Court noted that the NGA was framed "to afford consumers a complete, permanent and effective bond of protection from excessive rates and charges."

Section 7(b) of the NGA protects consumers against unwarranted termination of service by requiring prior Commission approval of the abandonment of service. *See Sunray Mid-Continent Oil Company v. FPC (Sunray II)*, 364 U.S. 137, 143 (1960), where this Court stated that Section 7(b) protects against the interruption of service, so there is regulation of "the great economic power of the pipeline companies as compared with that of communities seeking natural gas service." Moreover, "[n]o single factor in the Commission's duty to protect the public can be more important to the public than the continuity of service furnished." *Sunray Mid-Continent Oil Company v.*

FPC, 239 F.2d 97, 101 (10th Cir. 1956), *rev'd on other grounds*, 353 U.S. 944 (1957).[3]

This Court on several occasions has addressed the importance of continuity of service under Section 7(b). *See, e.g.*, *CATCO*, *supra*; *Sunray II*, *supra*, *see also*, *United Gas Pipe Line Company v. FPC*, 385 U.S. 83 (1966), where the Court held that United's refusal to take gas after the expiration of the contract term constituted an abandonment under Section 7(b) (*id.* at 86), because the transportation of gas in interstate commerce is a service covered by that provision (*id.* at 87). *See also United Gas Pipe Line Company v. McCombs*, 442 U.S. 529, 538 (1979), quoting from *Sunray II*, 364 U.S. at 158 n.25 (1960), "[w]e have consistently recognized that the Commission's 'legal control over the continuation of service' . . . is a fundamental component of the regulatory scheme."

If the finding of the court below that a customer must pay the highest possible rate in order to retain its service is upheld, then the consumer protections built into the NGA, as interpreted by this Court in *Hope*, *CATCO*, and the other decisions cited above, have no practical meaning. Continuity of service and protection from unreasonable rates are required to go hand-in-hand under the NGA, but that is not the case under the ROFR mechanism. Continuity of service is not maintained where a pipeline may terminate an existing service unless the shipper is

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3. *See Michigan Consolidated Gas Co. v. FPC*, 283 F.2d 204, 214 (D.C. Cir. 1960).

> The fact that abandonment of public service requires Government approval symbolizes the special legal status and obligations of common carriers and public utilities. This includes an obligation, deeply embedded in the law, to continue service.

willing to pay the highest possible rate, even though that customer is willing to pay the highest competitive rate bid.

II.

THE COURT OF APPEALS' DECISION ENDORSES ANTI-COMPETITIVE BEHAVIOR AND PERMITS THE EXPLOITATION OF CUSTOMERS.

Under the ROFR mechanism set up by FERC, competition was supposed to allocate pipeline capacity. As FERC explained,

> [t]he criteria established for pregranted abandonment for long-term transportation contracts of long-term firm transportation will foster competition and economic efficiency, and streamline the administrative process, while protecting the legitimate needs of many customers for continued service.

Pet. App. 319a. In addition, FERC claimed the ROFR procedure would: (i) allow "the rate to play a role in rationing capacity . . . ." (Pet. App. 323a); (ii) "recognize the role of market forces in determining contract price and term" (Pet. App. 675a); and (iii) permit "the market to determine contract terms" and allow "market forces to play a significant role in determining the contract price. . . ." Pet. App. 933a.

These noble pronouncements, however, were rendered meaningless due to the no discounting rule. In practice, market factors will not be allowed to have any effect on the disposition of capacity, since the pipeline is not obligated to contract for service at less than the maximum rate. This chasm between the announced purposes of FERC's ROFR mechanism and what actually occurs under that procedure was ignored by the court below.

In fact, the ROFR mechanism allows market forces to apply only where demand exceeds supply, a situation which benefits the pipeline by allowing it to sell its services at the maximum rate. If, however, the supply of pipeline capacity exceeds the demand,[4] market forces are rendered irrelevant and the shipper must pay the maximum rate, which is a situation that also benefits the pipeline. Thus, FERC's ROFR mechanism is anti-competitive, since it forces a customer to pay a rate for continued service which exceeds the market value of that service.

This is an obvious use of regulatorily sanctioned market power to exploit utility customers.[5] Moreover, compelling a customer to pay a non-competitive rate is patently inconsistent with FERC's basic rationale for establishing the ROFR bidding mechanism, which was to let market forces determine contract terms. Pet. App. 319a, 675a, 933a.

Pipeline customers who accept the cost burdens associated with firm transportation service (*i.e.*, paying monthly demand charges for capacity access whether the capacity is used or not)

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4. The amount of interstate pipeline capacity exceeds the demand for service in the nation's largest natural gas market, California. FERC made the following finding concerning the California gas market in *Secondary Market Transactions on Interstate Natural Gas Pipelines*, 77 FERC ¶ 61,183 at 61,707 (1996).

> [T]here is significant excess capacity available throughout California. Total interstate capacity into California currently exceeds demand by 2.0 Bcf/d. . . . [E]vidence . . . shows the capacity is trading at less than maximum rates.

Footnotes omitted.

5. *See, e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 27 n. 46 (1984), where this Court defined market power to exist "whenever prices can be raised above the levels that would be charged in a competitive market."

do so in order to assure themselves of guaranteed service of the highest priority. This is a particularly acute concern for captive shippers, especially those who have their own service obligations at the local level (*e.g.*, local distribution companies).[6] These customers strive for service continuity at the lowest possible rates. *See California, supra.*

FERC's no discounting rule, however, creates a conflict between these two statutorily recognized policies. Either the shipper can preserve its transportation service by paying a rate which exceeds market value (and which later may be deemed excessive and thus possibly unrecoverable by state or local regulators), or the shipper can forego guaranteed pipeline service and take the risk of meeting its customer demands through less secure means. That Hobbesian choice, however, is not consistent with the intent of the NGA, or with the holdings of this Court.

III.

FORCING A CUSTOMER TO PAY THE MAXIMUM RATE OR LOSE SERVICE IS AN EXERCISE OF MARKET AND/OR MONOPOLY POWER.

Before the court below, Petitioner argued that forcing an existing shipper to pay the maximum rate in order to retain service was an exercise of monopoly power where the market value of the service was less than the maximum rate. The court

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6. This Court noted the importance of the reliance by local communities on natural gas service as far back as *Sunray II*, 364 U.S. at 143 (1960):

> If the pipeline company were left free to cease its service to the local distribution company, a local economy which had grown dependent on natural gas as a fuel would be at its mercy.

below disagreed, noting that the ROFR mechanism restricted the pipeline's exercise of market power "by limiting the maximum rate that the pipeline may charge." Pet. App. 55a. The D.C. Circuit also based its conclusion on an earlier discussion in its opinion.

> If the existing customer is willing to pay the maximum approved rate, then the right-of-first-refusal mechanism ensures that the pipeline may not abandon the certificated service.

Pet. App. 49a.

This finding, however, fails to address specifically whether forcing a customer to pay the highest permissible rate set by a regulatory agency is an exercise of market power by a regulated utility where competition — and the ROFR procedure — fixes a lower value for the subject service. This appears to be a question of first impression for this Court.

Regulation by the FERC of the interstate transportation of natural gas is a legislative substitute for open competition made necessary by the natural monopoly positions of gas pipelines. *See, e.g., FPC v. Texaco, Inc.*, 417 U.S. 380, 397-8 (1974), where the Court noted:

> It is abundantly clear from the history of the Act and from the events that prompted its adoption that Congress considered that the natural gas industry was heavily concentrated and that monopolistic forces were distorting the market price for natural gas.

Footnote omitted.

Under the NGA, FERC establishes pipeline rates within a zone of reasonableness. *Public Service Commission v. FERC*, 813 F.2d 448, 451 (D.C. Cir. 1987), *citing Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). Thus, for each pipeline service in the tariff there appears a small minimum rate and a significantly higher maximum rate; both these rates — and all rates in between — are deemed just and reasonable. *Associated Gas Distributors v. FERC (AGD)*, 824 F.2d 981, 1007 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988). Consequently, if the pipeline were to renew an existing service at a market-determined price that was less than the maximum, that rate would be both lawful and just and reasonable.[7] FERC's ROFR mechanism, however, requires payment of the maximum rate or the loss of service.

There is nothing in the NGA or the decisions of this Court that compels a natural gas shipper to pay the maximum possible rate for transportation service. In fact, the decisions in *Hope* and *CATCO*, *supra*, compel the opposite conclusion in order to protect consumers from exploitation by pipeline monopolists. In addition, since FERC itself sets rates within a fairly wide zone of reasonableness, the highest rate has no better claim to being just and reasonable than any other rate within the range of reasonableness. Moreover, there is nothing in Section 7(b) which mandates a tie-in between service continuity and payment of the highest possible rate.

If a natural gas pipeline can force its customer to pay an above-market price for service, that is an exercise of market

7. It is undisputed that a rate less than the maximum is lawful, since any rate negotiated by the parties between the FERC-established minimum and maximum rates that appear in the pipeline tariff is permissible without a specific filing with FERC. Consequently, the ruling in *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, 497 U.S. 116 (1990), against the legality of a negotiated but unpublished rate that was less than the filed rate under the Interstate Commerce Act does not apply.

and/or monopoly power.[8] The fact that the rate being imposed on the customer is government sanctioned does not make it any less excessive. The effect on the customer is the same; the customer incurs costs that would not be possible in a competitive environment, and which should not be permitted in a regulatory environment.

IV.

THE COURT BELOW ERRED BY APPLYING SECTION 4 PIPELINE RATE ISSUES TO A SECTION 7(b) ABANDONMENT PROCEDURE.

The basis for the D.C. Circuit's affirmance of FERC's no discounting rule was to insure full cost recovery by the pipeline through its ability to constrain captive customers to pay the highest possible rate in order to continue their transportation service. *See, e.g.*, the D.C. Circuit's reference to the need for a pipeline to extract the maximum rate from its "demand-inelastic, captive customers." Pet. App. 55a. Pipeline cost recovery, however, is a Section 4 rate matter, not a Section 7(b) issue.

Even if pipeline cost recovery were relevant under Section 7(b), the FERC and the D.C. Circuit erred in asserting that a guarantee of pipeline cost recovery is an axiom of the NGA. In

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8. *See. e.g.*, *AGD*, 824 F.2d at 1010-1 (D.C. Cir. 1987),

> [P]ipeline transportation service is marked by a degree of natural monopoly. . . . In such an industry, "value-of-service" ratemaking (*i.e.*, rates varying on the basis of differing demand characteristics) has an established place, though not an uncontested one.

Footnotes omitted.

fact, pipelines are not guaranteed full cost recovery under the NGA, merely the opportunity to do so. *See, e.g., FPC v. Natural Gas Pipeline Company*, 315 U.S. 575, 590 (1942). "[T]he hazard of not making a profit remains on the company. . . ." *FPC v. Tennessee Gas Transmission Company*, 371 U.S. 145, 152 (1962). Moreover, there was no evidence cited by the court below to support its hypothesis that discounting service to firm transportation customers necessarily would lead to an inability of a pipeline to recover its cost of service. In fact, the D.C. Circuit made just the opposite finding in its review of the predecessor of Order Nos. 636, *et al.* with respect to the possible rate effects of discounting. *See AGD*, 824 F.2d at 1012.

The court below also should have taken into account that setting pipeline rates on a cost-of-service basis is not an exact science. For example, if a pipeline can lower its costs of operation or obtain additional throughput once the rates are set, it can earn a greater profit than anticipated in the ratemaking process. Thus, selling capacity to an existing shipper at less than the maximum rate does not, contrary to the opinion below, necessarily render meaningless the ability of the pipeline to earn its cost of service and/or charge the maximum rate.

In addition, the D.C. Circuit relied on FERC's assertion that if a pipeline failed to maximize throughput by withholding its capacity rather than selling it at a discount, the pipeline might not be able to recover all its costs in the next rate case. Pet. App. 936a. Neither FERC nor the court below explained, however, how this "threat" of future agency action resolved the immediate dilemma of an existing shipper who must either agree to a new service contract at an above-market rate or lose its transportation service.

Moreover, the D.C. Circuit also failed to address other deficiencies in the purported value of this "threat" by FERC.

For example, FERC's threat is not stated as a certainty, and thus it may prove meaningless in an actual pipeline rate case.[9] And, even if the "threat" were taken seriously, the pipeline still might elect to hold its capacity for future sale rather than undergo a review of all its rates in a new Section 4 rate case. The timing of a rate filing is an important factor ignored by the court below, since it is the pipeline and not FERC who controls when a Section 4 rate case will be filed. Finally, if a pipeline really jeopardized its opportunity for full cost recovery by not discounting when market factors dictate, there would be no reason for FERC's no discounting rule in the first place.

In addition, the court below failed to coordinate its holding on the no discounting rule with its decision to reverse and remand the requirement that ROFR renewals could be for a term of up to 20 years. Pet. App. 49a-53a. As conceived by FERC, the ROFR consisted of paying the highest lawful rate and agreeing to a contract term of up to 20 years. A commitment of that

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9. The D.C. Circuit described FERC

> as **assuring** that a pipeline is not entitled to full cost recovery in its next rate proceeding when it forgoes the opportunity to recover some of its fixed costs from a bid rate between the minimum and maximum filed rates.

Emphasis added, footnoted omitted; Pet. App. 55a. In fact, what FERC stated was:

> [I]f a pipeline fails to attempt to maximize throughput, there is no guarantee that it will be able to recover all the cost of its underutilized capacity from its customers when it files its next rate case.

Footnote omitted; Pet. App. 936a.

duration at a discounted rate might have been the reason FERC refused to require discounting, had FERC given a reason, however the 20-year term requirement has been reversed and remanded, with the indication that a much shorter term might be more appropriate.

At the time of the filing of this writ, FERC has not acted on the remand. However, if FERC amends its rules to provide for a much shorter contract term, the possible adverse effects on the pipeline of an ROFR discount will be reduced, thereby removing an obstacle to letting the market-determined rate apply to ROFR service renewal, and thus allowing a firm transportation customer to continue its service at the highest market-determined price.

V.

THE COURT BELOW ERRED BY VOLUNTEERING ITS OWN RATIONALE FOR THE AGENCY DECISION.

FERC repeatedly states as part of its ROFR mechanism that pipelines will not be required to discount their service. Pet. App. 637a, 936a. However, FERC never once explained why this is proper, despite requests to do so in the rulemaking process, and despite its recognition that the market value of pipeline capacity may be less than the maximum rate.

> If customers were able to renew service at less than the maximum rate, . . . this would merely be reflective of the competitive market. If no one bids at the maximum rate, that would mean that the capacity is valued at less than the maximum rate. However, pipelines are not required to discount under

> the rule and are not required to accept any offer at less than the maximum rate.

Pet. App. 673a.

The fact that the agency failed completely to explain a fundamental tenet of its decision should have been a sufficient basis to reverse this finding for a lack of reasoned decisionmaking. *See, e.g., AGA*, 912 F.2d at 1516-8; *Moraine Pipeline Company v. FERC*, 906 F.2d 5 (D.C. Cir. 1990); *Tarpon Transmission Company v. FERC*, 860 F.2d 439, 445 (D.C. Cir. 1988).

The court below, however, proceeded to provide its own rationale for FERC's no discounting rule. It was the court below, not FERC, who opined that discounting under the ROFR mechanism must be prohibited in order for pipelines to maximize their revenues from captive customers and thus avoid a purported cost underrecovery, and that abandonment could be avoided only if the existing shipper agrees to pay the maximum rate.[10]

Substituting the court's judgment and reasoning for that of the agency is directly contradictory to the fundamental principle of administrative law that an agency order must stand or fall on what the agency said. *FPC v. Texaco, Inc.*, 417 U.S. at 397; *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168-9 (1962); *SEC v. Chenery Corporation*, 332 U.S. 194, 196

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10. In this instance, there is no question of giving deference to the agency's interpretation of its enabling statute under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), since it was the court below, not FERC, who rendered this view of Section 7(b). Moreover, "an agency's interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear", *MCI Telecommunications Corp. v. American Telephone and Telegraph Co.*, 114 S. Ct. 2223, 2231 (1994).

(1947). Here, FERC said nothing to support its no discounting rule. Therefore, the court below erred in not reversing and remanding for the purpose of having FERC provide a rationale for its decision.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

KIM M. CLARK
Counsel of Record
JOHN, HENGERER & ESPOSITO
1200 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 429-8800

RICHARD M. BLUMBERG
Associate General Counsel
BURLINGTON RESOURCES OIL & GAS COMPANY
5051 Westheimer
Suite 1400
Houston, Texas 77056
(281) 878-3700

Attorneys for Petitioner

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Nos. 96-1186, 96-1187, 96-1188 and 96-1189

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATED GAS DISTRIBUTORS, ET AL., PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

AMERICAN PUBLIC GAS ASSOCIATION AND CITIZENS GAS & COKE UTILITY, PETITIONERS
v.
FEDERAL ENERGY REGULATORY COMMISSION

NEW YORK PUBLIC SERVICE COMMISSION, ET AL., PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

BURLINGTON RESOURCES OIL & GAS COMPANY, PETITIONER
v.
FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

WALTER DELLINGER
Acting Solicitor General
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

SUSAN TOMASKY
General Counsel
JOSEPH S. DAVES
Acting Solicitor
SUSAN J. COURT
ERIC LEE CHRISTENSEN
Attorneys
Federal Energy Regulatory Commission
Washington, D.C. 20426

29 pp

QUESTIONS PRESENTED

Order No. 636 of the Federal Energy Regulatory Commission (FERC) requires the unbundling of interstate natural gas transportation service from sales service in order to facilitate competition in the national market for gas at the wellhead and ensure equal access to transportation services. The questions presented are:

1. Whether FERC's jurisdiction over interstate transportation of natural gas under the Natural Gas Act, 15 U.S.C. 717 *et seq.*, supports application to local natural gas distribution companies and municipally owned natural gas companies of FERC regulations governing transfer of rights to capacity on interstate natural gas pipelines.

2. Whether FERC correctly concluded that, pursuant to its program for reallocation of pipeline capacity under long-term transportation contracts, it could not require natural gas pipelines to accept bids lower than the maximum just and reasonable rate for transportation capacity.

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In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-1186

ASSOCIATED GAS DISTRIBUTORS, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

No. 96-1187

AMERICAN PUBLIC GAS ASSOCIATION AND CITIZENS GAS AND COKE UTILITY, PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

No. 96-1188

NEW YORK PUBLIC SERVICE COMMISSION, ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION AND UNITED STATES OF AMERICA

No. 96-1189

BURLINGTON RESOURCES OIL & GAS COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-174a)[1] is reported at 88 F.3d 1105. The orders of the Commission are reported in Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation Under Pt. 284 of the Commission's Regulations, and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,939 (Pet. App. 175a-407a), order on reh'g, Order No. 636-A, F.E.R.C. Stats. & Regs. (CCH) ¶ 30,950 (Pet. App. 408a-812a), order on reh'g, Order No. 636-B, 61 F.E.R.C. (CCH) ¶ 61,272 (Pet. App. 813a-998a), reh'g denied, 62 F.E.R.C. (CCH) ¶ 61,007 (Pet. App. 999a-1000a) (Order No. 636).

JURISDICTION

The judgment of the court of appeals was entered on July 16, 1996. A petition for rehearing was denied on October 29, 1996. Pet. App. 1003a-1004a. The petitions for a writ of certiorari were filed on January 27, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In the rule at issue here, Order No. 636, the Federal Energy Regulatory Commission (FERC or Commission) completed the natural gas deregulatory program it had initiated almost a decade earlier. Order No. 636 mandates the "unbundling" of interstate natural gas sales service from transportation service, requiring that those services be sold separately to

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[1] All references to "Pet. App." are to the appendix to the petition in No. 96-1186.

natural gas purchasers. FERC adopted its mandatory unbundling policy in order to "improve the competitive structure of the natural gas industry to facilitate the operation of a national wellhead market as envisioned by Congress," Pet. App. 229a; to "ensure equality of transportation service between gas sold by pipelines or their affiliates and gas sold by other sellers," *id.* at 234a; and, ultimately, to "provide natural gas consumers with access to an adequate supply of clean and abundant natural gas at reasonable prices," *id.* at 229a. Order No. 636 imposes "capacity-release" requirements that allow holders of firm transportation rights on interstate pipelines to resell those rights under uniform terms. *Id.* at 244a-252a.[2] The order also imposes right-of-first refusal (ROFR) requirements, which allow existing shippers with long-term transportation contracts to retain their rights to pipeline capacity if they agree to match the highest bid for that service from alternative purchasers, up to the maximum cost-based transportation rate for the service approved by the Commission under the Natural Gas Act (NGA), 15 U.S.C. 717 *et seq.* Pet. App. 671a-692a.

2. In 1985, FERC initiated a deregulatory program designed to encourage the voluntary unbundling of pipeline gas sales from pipeline transportation services. Whereas pipelines had traditionally bought gas at the wellhead and transported it before turning it over to the purchaser, the Commission dramatically

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[2] Transportation is referred to as "firm" when delivery is guaranteed without interruption, as distinguished from "interruptible" transportation, which may be interrupted to accommodate the requirements of firm shippers. See Pet. App. 11a n.10.

changed the natural gas industry by enabling pipelines to offer gas sales and transportation services separately, thereby affording customers the opportunity to purchase gas from one company and hire a separate company's pipeline to transport it. See Pet. App. 10a-15a (discussing background to Order No. 636). To further enhance the efficiency of the natural gas market, the Commission encouraged pipeline customers, through a variety of mechanisms, to sell or release their unwanted firm transportation capacity to other shippers.

The partial unbundling of sales and transportation service that resulted from the voluntary program presented serious inefficiencies in allocation of unused transportation capacity. For example, because bundled firm service had often provided superior reliability, many customers continued to pay reservation fees to retain that service, while in most instances using cheaper interruptible service to transport their wellhead gas. See Pet. App. 15a-16a. The secondary transportation market that resulted from partial unbundling produced such a wide variety of capacity-reallocation arrangements that it became impossible for FERC to monitor those programs adequately in order to "ensure that all allocations are nondiscriminatory"; there were "simply too many potential assignors of capacity" for FERC to assure that capacity was allocated "in a manner consistent with the public convenience and necessity." *Algonquin Gas Transmission Co.*, 59 F.E.R.C. (CCH) ¶ 61,032, at 61,095 (Apr. 8, 1992), reh'g denied, 60 F.E.R.C. (CCH) ¶ 61,113 (Aug. 3, 1992).[3] Accordingly, the Commission

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[3] In the *Algonquin* orders, which were issued as companion orders to Order No. 636, the Commission revoked the certifi-

found that the continued operation of the voluntary capacity reallocation programs it had previously approved "would frustrate the goal of * * * remedy[ing] an unreasonable restraint of trade" and would therefore be "unjust and unreasonable and contrary to the public interest." 59 F.E.R.C. (CCH) ¶ 61,032, at 61,096-61,097.

3. To address the problems that arose from partial, voluntary unbundling, FERC's Order No. 636 mandates the complete unbundling of pipeline sales from transportation service and institutes a number of requirements to achieve a fair and open market for transportation rights, and to prevent undue discrimination. See Pet. App. 15a-18a (summarizing Order No. 636).

FERC established, *inter alia*, a uniform capacity-release rule to ensure that unneeded transportation capacity on interstate pipelines is allocated fairly and efficiently. See Pet. App. 71a-103a, as amended by Pet. App. 1001a-1002a, 244a-252a.[4] Under FERC's rule, any shipper desiring to release firm capacity must notify the affected interstate pipeline. The pipeline must then post the available capacity, along with applicable conditions, on an electronic bulletin board for a reasonable period of time, and assign the capacity to the shipper making the best offer for the capacity, up to the maximum just and reasonable price established by the Commission. *Id.* at 245a-247a. A

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cates of public convenience and necessity it had previously issued for capacity reallocation programs and required instead that pipelines abide by the uniform capacity reallocation program of Order No. 636. Review of those orders was consolidated with review of Order No. 636. Pet. App. 19a & n.20.

[4] FERC's capacity-release rule is codified at 18 C.F.R. 284.243.

shipper releasing firm capacity transportation rights may designate a specific party to receive those rights, but the pipeline must post such a prearrangement on the electronic bulletin board, and the designated party can receive the transfer only if no other party makes a better offer. *Id.* at 244a-247a. If the designated shipper bids at the ceiling rate, however, it automatically receives the transportation rights. *Id.* at 245a.

In addition, FERC recognized that, if the wellhead market for natural gas is to function effectively, transportation should be made equally available to all gas purchasers, regardless of whether the wellhead merchant is affiliated with the pipeline. Pet. App. 234a-235a. The principle of "transportation equality" protects captive customers—*i.e.* those connected to only one pipeline, who typically have long-term contracts—from the pipeline's market power. To implement that principle, Order No. 636 imposes, *inter alia*, a "right-of-first-refusal" (ROFR) process allowing competitive allocation of capacity at the expiration of long-term contracts for pipeline transportation, while protecting customers with expiring contracts who remain dependent upon continued transportation service. See *id.* at 43a-56a.

As a condition of granting pipelines authority, under Section 7(b) of the NGA, 15 U.S.C. 717f(b), to abandon contracts at the end of their terms, FERC required pipelines to institute a ROFR mechanism inviting renewal of any long-term contract if the existing shipper matches the highest offer (up to a maximum just and reasonable rate) from any competing bidder for the transportation capacity. 18 C.F.R.

284.221(d); Pet. App. 668a-673a.[5] FERC reasoned that, in general, "a pipeline's service obligation * * * should be determined, in the first instance, by the contract negotiated by the parties," *id.* at 312a, and pipeline transportation capacity is most efficiently allocated if it is sold to those willing to pay the highest price for the capacity, *id.* at 675a. The Commission recognized, however, that where contracts for longer than one year are involved, existing customers may rely on continued service and require some assurance that their current long-term contracts can be extended.

The Commission concluded that the ROFR mechanism "strikes the appropriate balance between the needs of customers for continued service and the benefits of competition in establishing the terms of service." Pet. App. 325a.

4. The court of appeals upheld in large part FERC's Order No. 636, remanding only issues not relevant here. The court concluded that FERC's plenary jurisdiction over interstate transportation of gas on interstate pipelines gives it the authority to regulate the exchange of interstate transportation capacity. Pet. App. 71a-94a. Uniform capacity-release requirements "operate as a term or condition of pipeline service" that FERC may apply to all parties engaged in such interstate transactions, including parties that otherwise are exempt from FERC jurisdiction as local distribution companies (LDCs)

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[5] A pipeline must also extend a contract if it contains either an evergreen or a rollover clause. Such clauses allow parties to extend their contract for a specified term upon the contract's expiration. See Howard R. Williams, *Manual of Oil & Gas Terms* 406-407, 1083-1084 (8th ed. 1991).

or municipally-owned natural gas distributors (municipals). *Id.* at 80a. The court rejected petitioners' asserted distinction between "rights to" and "rendition of" service, concluding that, "[w]hile the pipeline provides *transportation* only when a party utilizes capacity rights to transport gas, the pipeline provides *transportation services* throughout the capacity release process." *Ibid.* (emphasis in original).

The court also rejected several challenges to the ROFR mechanism. Pet. App. 43a-56a.[6] The court upheld the Commission's conclusion that it could not require pipelines considering existing customers' bids under the ROFR mechanism to accept rates below the maximum just and reasonable rate. *Id.* at 53a-56a. The court also concluded that the Commission had included adequate safeguards in Order No. 636 against pipeline manipulation of bids, that there was no basis upon which to require pipelines to accept bids at less than the approved rate, and that the Commission had provided proper incentives in the ROFR process to encourage pipelines to accept discounted rates. *Ibid.*

ARGUMENT

Petitioners challenge the court of appeals' decision upholding the capacity-release and ROFR requirements of Order No. 636. That decision is consistent with the well established principle that the NGA

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[6] Although the court generally affirmed the Commission's ROFR mechanism, it remanded for further consideration the requirement that, in order to retain their existing pipeline capacity, existing shippers must match bids for terms of up to 20 years duration. Pet. App. 49a-53a. On remand, the Commission shortened the maximum term to five years. Order No. 636-C, 78 F.E.R.C. (CCH) ¶ 61,186 (Feb. 27, 1997).

granted FERC "exclusive jurisdiction 'over the sale and transportation of natural gas in interstate commerce,'" *Northwest Cent. Pipeline Corp.* v. *State Corp. Comm'n*, 489 U.S. 493, 510 (1989), and with the decisions of this and other courts construing that grant of jurisdiction. Further review is not warranted.[7]

1. Petitioners Associated Gas Distributors, et al. (AGD) (No. 96-1186), the New York Public Service Commission, et al. (NYPSC) (No. 96-1188) and the American Public Gas Association, et. al. (APGA) (No. 96-1187) challenge the court's affirmance of the capacity-release requirements in Order No. 636. The court of appeals correctly concluded that FERC's capacity-release program is a legitimate exercise of its plenary jurisdiction under the NGA to regulate the transportation of gas in interstate commerce.

a. There is no merit to petitioners' contentions (96-1186 Pet. 18-24; 96-1188 Pet. 13-16) that the Com-

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[7] Order No. 636 comports with FERC's obligation under the NGA to ensure consumers a supply of gas "at the lowest possible reasonable rate." *Atlantic Ref. Co.* v. *Public Serv. Comm'n*, 360 U.S. 378, 388 (1959). As recent studies demonstrate, consumers have reaped substantial benefits from the Commission's decade-long restructuring of the natural gas industry, of which Order No. 636 represents the "latest step." Pet. App. 6a. Specifically, adjusted for inflation, prices paid by local utilities for gas at the "city gate" dropped by 52% in the last decade, prices paid by residential and commercial customers dropped 32% and 38%, respectively, and prices paid by industrial and electric utility customers fell by approximately 60%. Those figures demonstrate that "open access has placed strong pressures on interstate pipelines to reduce their costs and pass the savings through to their customers." Robert Crandall & Jerry Ellig, *Economic Deregulation and Customer Choice: Lessons for the Electric Industry* 10-11 (1997).

mission lacks jurisdiction to apply its capacity-release rules to capacity on interstate pipelines held by LDCs. As the court of appeals concluded, "FERC's capacity release program is a legitimate exercise of its jurisdiction over the interstate transportation of natural gas." Pet. App. 77a. Section 1(b) of the NGA grants the Commission jurisdiction over three distinct aspects of the natural gas industry: (1) "the transportation of natural gas in interstate commerce," (2) "the sale in interstate commerce of natural gas for resale for ultimate public consumption," and (3) "natural-gas companies engaged in such transportation or sale." 15 U.S.C. 717(b); see *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 636 (1972) (*LP&L*). As this Court has emphasized, the Commission's transportation jurisdiction is "plenary" and extends to all transactions "except those which Congress has made explicitly subject to regulation by the States." *FPC* v. *Southern California Edison Co.*, 376 U.S. 205, 216 (1964). Further, as this Court has repeatedly stressed, the Commission's power extends to regulating transactions that, if left unregulated, could interfere with the achievement of the goals of the NGA. *Schneidewind* v. *ANR Pipeline Co.*, 485 U.S. 293, 310 (1988); *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Bd. of Mississippi*, 474 U.S. 409, 423-424 (1986); *United Gas Pipe Line Co.* v. *McCombs*, 442 U.S. 529, 538 (1979).

The court of appeals' conclusion that the uniform capacity-release requirements are an appropriate exercise of FERC's jurisdiction over interstate transportation of natural gas (Pet. App. 79a-86a) follows naturally from this Court's rulings that the Commission's transportation jurisdiction extends to, for example, the end-use of the transported gas, see *FPC*

v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 7-8, 22 (1961), interruption of interstate transportation service, see *Panhandle Eastern Pipe Line Co.* v. *FPC*, 332 U.S. 507, 523 (1947), curtailment of gas sales, see *LP&L*, 406 U.S. at 641, financing of interstate pipelines, see *Schneidewind*, 485 U.S. at 306, and gas storage, see *id.* at 295 n.1. The court of appeals' decision is consistent with the decisions of all the other circuits that have addressed challenges to FERC's exercise of its transportation jurisdiction.[8]

Moreover, the court of appeals correctly noted that, "[a]s an entirely separate matter," FERC's jurisdiction over abandonments of service supports its regulation of capacity-release transactions because, "[i]n effect, the pipeline is temporarily abandoning service to the releasing shipper and instituting service to the replacement shipper." Pet. App. 80a. Under Section 7(b) and (c) of the NGA, neither abandonment nor ren-

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[8] Other circuits have unanimously held that FERC's jurisdiction extends broadly to all aspects of transportation, including the "initiation, curtailment, quality, quantity, and termination" of gas deliveries. *National Ass'n of Regulatory Util. Comm'rs* v. *FERC*, 823 F.2d 1377, 1385 (10th Cir. 1987). See, *e.g.*, *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987) (limiting liability for curtailments); *Fort Pierce Util. Auth.* v. *FPC*, 526 F.2d 993, 996-998 (5th Cir. 1976) (curtailment of retail gas sales); *Corning Glass Works* v. *FERC*, 675 F.2d 392, 394-396 (D.C. Cir. 1982) (spreading of costs of liquified natural gas plant built by LDC to service customers within its territory); *Mississippi Pub. Serv. Comm'n* v. *FPC*, 522 F.2d 1345, 1350 (5th Cir. 1975) (compensating end users for losses caused by curtailments), cert. denied, 429 U.S. 870 (1976); *Panhandle E. Pipe Line Co.* v. *FPC*, 232 F.2d 467, 472 (3d Cir.) (control over the functioning of a pipeline's facilities), cert. denied, 352 U.S. 891 (1956).

dition of new service may occur without permission and prior approval of the Commission. 15 U.S.C. 717f(b) and (c).[9]

b. Petitioners incorrectly assert (96-1186 Pet. 18-21; 96-1188 Pet. 14-16) that regulation of LDCs' assignment of transportation capacity rights to gas consumers operating within the LDCs' service areas is tantamount to regulation of local distribution. Capacity-release involves assignment of rights to use firm interstate transportation capacity on high-pressure trunk lines. Those lines are not "local distribution facilities" within the meaning of Section 1(b) of the NGA. See *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 470 (1950). FERC has not in Order No. 636 asserted jurisdiction over any activity occurring behind the city gate after the LDC has received gas from an interstate pipeline. Capacity release does not solely affect LDC capacity assignments to end-users located in local service areas, but enables all firm capacity holders, including LDCs, end-users, and marketers, to deliver gas to any existing, out-of-state delivery point on the interstate pipeline upstream of its city gate or usual delivery point. See Pet. App. 271a, 555a. Deliveries of gas to those out-of-state locations under assigned capacity rights cannot be deemed local distribution of gas, nor can any State

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[9] Petitioner NYPSC asserts (96-1188 Pet. 16), without authority, that the court of appeals erred in concluding that the Commission could regulate partial abandonments of service under Section 7 of the NGA. Petitioner's argument that partial abandonments cannot be regulated would create a serious gap in the Commission's regulatory powers and, in any event, ignores the plain requirement of Section 7(b) that a pipeline may not abandon "*any* service," 15 U.S.C. 717f(b) (emphasis added), without Commission approval.

regulate those out-of-state capacity assignments. See *Mississippi River Transmission Corp.* v. *FERC*, 969 F.2d 1215, 1218 (D.C. Cir. 1992); *Michigan Consol. Gas Co.* v. *FERC*, 883 F.2d 117, 121 (D.C. Cir. 1989), cert. denied, 494 U.S. 1079 (1990).

Even where an LDC assigns its firm capacity on an interstate pipeline to a local end-user, settled precedent makes clear that such a transaction does not constitute local distribution of gas. Indeed, the "local distribution" exception to FERC transportation jurisdiction is "confined to [an LDC's] parcelling out function and (probably) even more narrowly, to parcelling out *accompanied by* retail sales." *Public Utils. Comm'n* v. *FERC*, 900 F.2d 269, 276 (D.C. Cir. 1990). Thus, contrary to petitioners' assertions (96-1186 Pet. 16; 96-1188 Pet. 19-20), the court of appeals' application here of Section 1(b)'s established construction is consistent with the holdings of this Court, *e.g.*, *LP&L*, 406 U.S. at 637-638; *East Ohio*, 338 U.S. at 469-470, and other courts of appeals, *Cascade Natural Gas Corp.* v. *FERC*, 955 F.2d 1412, 1418 (10th Cir. 1992); *United Gas Pipe Line Co.* v. *FERC*, 824 F.2d 417, 425 (5th Cir. 1987), and plainly expressed congressional intent, H.R. Rep. No. 709, 75th Cong., 1st Sess. 3 (1937) ("local distribution * * * is made only to consumers *in connection with sales*" (emphasis added; internal quotation marks omitted)).

c. Petitioner AGD incorrectly asserts (96-1186 Pet. 21-24) that FERC has used unbundling to interfere with matters that are traditionally controlled by the States. Petitioner ignores the pivotal fact that States have never regulated the terms and conditions of interstate pipeline transportation. As the District of Columbia Circuit explained in *Public Utils. Comm'n*, 900 F.2d at 276-277:

> In an era when transporters almost invariably bought gas at one end of the pipeline and sold it at the other, gas would normally reach an end user only after a pipeline's retail sale to that user, a transaction unquestionably under the state's control, or after conventional distribution and sale by a local distributor, again clearly subject to state control. * * * Under modern conditions, by contrast, where the end user often owns the gas and uses the pipeline solely for transportation, application of *East Ohio* removes this fulcrum for state power.

See *East Ohio*, 338 U.S. at 469-470; *Cascade Natural*, 955 F.2d at 1421.

Petitioners' contentions (96-1186 Pet. 24-28; 96-1188 Pet. 13-14) that capacity release interferes with state regulation of the LDCs' traditional role as local supplier of natural gas are similarly unfounded. An LDC's use of the capacity-release program is voluntary and is aimed at unused (and presumably unneeded) capacity. See Pet. App. 244a-245a. FERC does not regulate any aspect of the rates for an LDC's retail sale of its system supply or the use of its own facilities; it regulates only the LDC's use of interstate transportation capacity. As the court of appeals observed, Section 1(b) "does not withdraw from FERC's jurisdiction any aspect of the interstate transportation of natural gas." Pet. App. 82a.

Contrary to NYPSC's assertions (96-1188 Pet. 13-14), the uniform capacity-release mechanism is not unfair to end-users who have "paid" for LDC "pipeline capacity" through "state-approved rates." Under Order No. 636, an LDC's customer can guarantee assignment of the LDC's interstate capacity rights by

contracting with the LDC at the FERC-approved, cost-based transportation rate, or at any lower rate that trumps competing offers. Pet. App. 485a. By allowing LDCs to shed unused capacity and thereby lower costs, the capacity-release mechanism benefits consumers.

AGD incorrectly contends (96-1186 Pet. 27-28) that the capacity-release program impairs state efforts to require LDCs to unbundle local transportation service from retail sales. Rather than imposing obstacles, however, FERC's rule facilitates local unbundling by guaranteeing end-users access not only to their own LDCs' released capacity, but also to the capacity released by any other capacity holder who holds rights to a delivery point at or downstream of the LDC's position on the interstate pipeline. See Pet. App. 271a-272a, 495a-497a.[10]

d. AGD also errs in asserting (96-1186 Pet. 14-18) that the Hinshaw Amendment to the NGA, Pub. L. No. 323, 68 Stat. 36, exempts LDCs from the uniform capacity reallocation mechanism. The Hinshaw Amendment exempts from FERC regulation any person engaged in the transportation or sale in inter-

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[10] AGD argues (96-1186 Pet. 27) that Order No. 636 interferes with "blended" capacity programs now being offered by the States. That argument was neither raised before nor addressed by the Commission or the court of appeals, and there is no factual basis in the record to support it. That claim therefore is not properly presented to this Court. See 15 U.S.C. 717r(b) ("No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing."); see also *Sullivan* v. *Louisiana*, 508 U.S. 275, 279 n.1 (1993) (stating that this Court does not ordinarily review issues not raised below).

state commerce of natural gas received "within or at the boundary of a State" and "ultimately consumed within such State." 15 U.S.C. 717(c). Congress enacted the Hinshaw Amendment "to preserve state control over local distributors who purchase gas from interstate pipelines * * * [but] Congress did not intend the amendment to relieve the Commission of jurisdiction over * * * integrated interstate systems." *Louisiana Power & Light Co.* v. *FPC*, 483 F.2d 623, 633 (5th Cir. 1973), cert. denied, 416 U.S. 974 (1974). As the court of appeals explained, "the Commission's authority to regulate capacity release arises from its jurisdiction over the interstate pipeline that consummates the transaction and the subject of the transaction, the interstate transportation of gas, entirely independent of its jurisdiction over the releasing or replacement shippers." Pet. App. 82a n.62. Moreover, in order for the Hinshaw Amendment to apply, the service at issue would have to be subject to effective state regulation. The States cannot effectively regulate the transactions at issue here because they cannot prevent interstate pipelines from discriminating in favor of in-state users at the expense of out-of-state users. The Hinshaw Amendment accordingly has no application to the interstate transactions at issue here.

AGD places great weight on its contention (96-1186 Pet. 17) that the Hinshaw Amendment overruled this Court's decision in *East Ohio*, 338 U.S. at 461. Although *East Ohio*'s holding—that FERC had jurisdiction over an interstate gas pipeline operating in only one State—is no longer the law, the Hinshaw Amendment did not affect the Court's analysis in *East Ohio* of the scope of the Commission's jurisdiction over pipelines that transport gas across state lines. See

Altamont Gas Transmission Co. v. *FERC*, 92 F.3d 1239, 1246 (D.C. Cir. 1996), petition for certiorari pending, No. 96-1179 (filed Feb. 11, 1997); *Public Utils. Comm'n*, 900 F.2d at 275 n.4. Notwithstanding the particular change brought about by the Hinshaw Amendment, this Court and the courts of appeals have continued consistently to rely on *East Ohio* as a correct and otherwise still valid interpretation of the NGA. *E.g.*, *LP&L*, 406 U.S. at 636-637 & n.13; *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965); *Cascade Natural*, 955 F.2d at 1416-1421; *Public Utils. Comm'n*, 900 F.2d at 275.

e. APGA similarly contends (96-1187 Pet. 9-11) that the court of appeals erred in concluding that municipally owned gas companies must comply with the uniform capacity reallocation mechanism when they seek to reassign interstate pipeline capacity. APGA reasons that, because Section 2 of the NGA excludes municipals from the definition of "persons" regulated as "natural gas companies" under the Act, 15 U.S.C. 717a(1)-(3) and (6), FERC may not require that they comply with the terms of FERC's capacity-release program. 96-1187 Pet. 7-8. The court of appeals correctly concluded, however, that "FERC may, consistent with the NGA, require municipalities to comply with its capacity release regulations" because "FERC's transportation jurisdiction extends as a separate matter over capacity release * * * entirely independent of the jurisdictional nature of the releasing and replacement shippers." Pet. App. 84a-85a.

Although FERC lacks jurisdiction to regulate municipals as such, the Commission's jurisdiction over interstate transportation is not limited to natural-gas companies or "persons" engaged in transportation.

Instead, it extends to all interstate transportation of gas, regardless of the parties involved in such transportation. This Court has rejected the contention "that the word 'transportation' in § 1(b) must be construed as applying only to companies engaged in the business of transporting gas in interstate commerce," concluding that "the Act's language did not express any such limitation." *East Ohio*, 338 U.S. at 468. Indeed, the courts have long recognized that municipalities, although not "natural-gas companies" or "persons" under the Act, are nonetheless subject to NGA regulation under those NGA provisions that are not exclusively directed at "natural-gas companies." See, *e.g.*, *California* v. *Southland Royalty Co.*, 436 U.S. 519, 528 (1978); *Public Serv. Co.* v. *FERC*, 587 F.2d 716, 719 (D.C. Cir. 1979). Thus, as the court of appeals observed (Pet. App. 85a), this Court has concluded that the Commission may properly regulate the curtailments of both gas supply and capacity to municipals under its transportation jurisdiction, see *Transcontinental Gas*, 365 U.S. at 20-22; *LP&L*, 406 U.S. at 640—a situation involving allocation of transportation capacity among shippers in compliance with federal mandates that is "strikingly similar" to capacity release. Pet. App. 85a.[11]

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[11] APGA argues (96-1188 Pet. 13-14) that there is a distinction between transactions in the primary and secondary market for pipeline capacity. As we have noted, pages 10-11, *supra*, however, the Commission's jurisdiction over transportation extends to all aspects of interstate pipeline operation. Further, to declare such secondary transactions beyond the Commission's jurisdiction would create an anomalous gap in the comprehensive regulation intended by Congress in enacting the NGA. See *LP&L*, 406 U.S. at 631-632.

APGA further contends (96-1187 Pet. 12-19) that FERC's regulation of municipalities under its transportation jurisdiction conflicts with FERC's own policy established in *Texas Eastern Transmission Corp.*, 51 F.E.R.C. (CCH) ¶ 61,170 (May 11, 1990). The court of appeals correctly rejected that contention. Pet. App. 84a & n.64. In *Texas Eastern*, the Commission authorized firm transportation customers of an interstate pipeline to broker capacity to third parties without the involvement of the carrying pipeline itself. The Commission required such customers to obtain "limited jurisdiction" certificates under Section 7(c) of the NGA because, as brokers, they were within the meaning of NGA Section 1(b). The Commission, however, ruled that municipals were exempt transporting gas from any such certification requirement because they were not "natural gas companies" and therefore not subject to Section 7. See 48 F.E.R.C. (CCH) ¶ 61,248, at 61,873-61,875 (Aug. 22, 1989); 51 F.E.R.C. (CCH) ¶ 61,170, at 61,453-61,454. The capacity brokering arrangements in *Texas Eastern* were performed by capacity holders themselves without pipeline involvement; under Order No. 636, in contrast, FERC regulates capacity assignment by pipelines. The court of appeals thus correctly held that the *Texas Eastern* approach is inapplicable, and that FERC may require municipals' compliance with capacity-release rules as it may require their compliance with other pipeline terms or conditions of interstate transportation service. Pet. App. 84a-85a.[12]

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[12] *Texas Gas Transmission Corp.*, 55 F.E.R.C. (CCH) ¶ 61,208 (May 13, 1991), and *United Gas Pipe Line Co.*, 46 F.E.R.C. (CCH) ¶ 61,060 (Jan. 24, 1989), modified on other grounds, 49 F.E.R.C. (CCH) ¶ 61,166 (Nov. 7, 1989), followed

Finally, there is no merit to APGA's assertion (96-1187 Pet. 19-20) that the Commission's capacity-release mechanism is merely a sham designed to expand its jurisdiction. As the court of appeals observed, under Order No. 636, "[t]he pipelines' role in capacity release is absolutely central, and the transaction itself controls access to interstate transportation capacity." Pet. App. 84a-85a (footnote omitted). Order No. 636 requires pipelines to maintain electronic bulletin boards upon which proposed transactions are posted, administer the rules for operation of the bidding system, and select the successful bidder. In short, as the court observed, capacity release necessarily involves movement of gas in interstate commerce by the assignee of capacity rights because "[b]y controlling such capacity, the assignors are effectively determining by whom, and under what circumstances, gas will be transported and are using the pipeline's facilities as if they were the assignors' facilities." *Id.* at 81a.

2. Petitioner Burlington Resources Oil & Gas Company (Burlington) (No. 96-1189) argues that the court of appeals erred in affirming FERC's conclusion that pipelines allocating long-term transportation rights under the ROFR mechanism do not have to accept bids at less than the maximum, cost-based just and reasonable rate established by the Commission under the NGA. Burlington asserts (96-1189 Pet. 7-9) that the ROFR rule violates the Commission's obligation under the NGA to protect consumers. As the court of appeals concluded, however, "the basic structure of the [ROFR] mechanism provides

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the *Texas Eastern* approach, and APGA's reliance on those decisions (96-1186 Pet. 14) similarly fails to support the petition.

the [customer] protections from pipeline market power required for pre-granted abandonment under [NGA] § 7." Pet. App. 49a; see also *id.* at 54a-55a. The ROFR procedure "guarantees that existing customers may have continued service," and "affords protection to the existing customer against *any* exercise of monopoly power," *id.* at 933a (emphasis added), because the customer will be required to pay, at most, the cost-based just and reasonable rate established by the Commission in a ratemaking proceeding, *id.* at 679a. As the court of appeals observed, the NGA "protect[s] customers against loss of service only if the customer is willing to pay the maximum rate approved in a rate proceeding." *Id.* at 55a. The Commission concluded that the ROFR mechanism "provides more than adequate protection that pipelines will not be able to charge monopoly rates for their service." *Id.* at 672a. This Court approved a very similar pricing mechanism in *Mobil Oil Exploration & Producing Southeast, Inc.* v. *United Distribution Cos.*, 498 U.S. 211 (1991) (upholding FERC rule setting maximum "just and reasonable" rate for gas sold under Natural Gas Policy Act price ceilings, but allowing sellers voluntarily to accept lower prices if market conditions dictate).[13]

Contrary to Burlington's assertions (96-1189 Pet. 11-12), FERC's decision to leave to pipelines' discretion whether to accept below-ceiling bids voluntarily does not encourage anti-competitive behavior. The

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[13] If a pipeline elects to leave capacity idle rather than accept a below-ceiling bid for that capacity, the shipper may also file a petition with the Commission under Section 5 of the NGA claiming that the pipeline's action is "unjust, unreasonable, unduly discriminatory, or preferential." 15 U.S.C. 717d(a).

Commission cannot require a pipeline to accept rates below the cost-based just and reasonable rate ceiling under the Commission's ROFR program. Those rates are, by definition, the lowest rates that ensure pipelines an adequate return on their investment; requiring pipelines to accept a lower rate would put them at risk of under-recovery in violation of the Commission's duty to ensure pipelines sufficient returns and adequate capitalization. See *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (rates must "assure confidence in the financial integrity" of the regulated entity "so as to maintain its credit and attract capital"); *Permian Basin Area Rate Cases*, 390 U.S. 747, 792 (1968) (rates must "maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection for the relevant public interests"); *Associated Gas Distribs.* v. *FERC*, 824 F.2d 981, 1007-1013 (D.C. Cir. 1987), cert. denied, 485 U.S. 1006 (1988).

Burlington also errs in arguing (96-1189 Pet. 12-15) that FERC should have imposed a rate within the zone of approved rates, but below the maximum just and reasonable rate. Burlington relies chiefly on *Associated Gas*. The pricing mechanism approved in *Associated Gas* established a cost-based just and reasonable rate, but allowed pipelines to "consent to selective discounting" down to prescribed minima. 824 F.2d at 1010. That voluntary discounting approach is precisely the approach taken here.[14]

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[14] Burlington misconstrues cases holding that FERC may establish rates within a "zone of reasonableness." See 96-1189 Pet. 14. That test applies to judicial review of the Commission's rates, not to the establishment of those rates in the first

Finally, Burlington errs in asserting (96-1189 Pet. 18-20) that FERC failed to provide a rationale for its decision not to require pipelines to accept discounted rates under the ROFR process, and that the court of appeals supplied its own rationale. The Commission's statement that pipelines "are not required to accept any offer at less than the maximum rate," Pet. App. 673a, correctly reflects existing law on that point. See page 22, *supra*. Each of the rationales relied upon by the court of appeals was also articulated in the Commission's orders. See Pet. App. 671a-673a, 935a-937a. In any event, a reviewing court retains the power to identify the proper construction of the governing law, even if not argued by the Commission. *Arcadia* v. *Ohio Power Co.*, 498 U.S. 73, 77 (1990).

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instance. See *Permian Basin*, 390 U.S. at 767. Burlington also asserts (96-1189 Pet. 16) that the NGA does not guarantee pipelines cost recovery, but only affords them the opportunity to recover their costs. That opportunity, however, must include the possibility of recovering adequate returns on capital investment, which, by definition, turns on the cost-based rate established by the Commission.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General

SUSAN TOMASKY
General Counsel
JOSEPH S. DAVES
Acting Solicitor
SUSAN J. COURT
ERIC LEE CHRISTENSEN
Attorneys
Federal Energy
Regulatory Commission

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No. 96-1189

IN THE
Supreme Court of the United States
OCTOBER TERM 1996

BURLINGTON RESOURCES OIL & GAS COMPANY,
Petitioner,

vs.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia

REPLY BRIEF OF PETITIONER BURLINGTON RESOURCES OIL & GAS COMPANY

Kim M. Clark
Counsel of Record
JOHN, HENGERER & ESPOSITO
1200 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 429-8800

Richard M. Blumberg
Associate General Counsel
BURLINGTON RESOURCES
OIL & GAS COMPANY
5051 Westheimer
Suite 1400
Houston, Texas 77056
(713) 624-9270

Attorneys for Petitioner

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PARENT COMPANIES AND NONWHOLLY OWNED SUBSIDIARIES

The statement which appeared in the Petition remains correct.

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Burlington Resources Oil & Gas Company (Burlington Resources) herewith files its reply to the Brief For The Federal Energy Regulatory Commission (FERC) in Opposition (FERC Brief). The decision below to which this Petition applies is *United Distribution Companies, et al. v. Federal Energy Regulatory Commission*, 88 F.3d 1105 (D.C. Cir. 1996). Pet. App. 1a-174a.

ARGUMENT

At issue in this Petition is whether, under the right of first refusal (ROFR) mechanism inaugurated by FERC as part of its Order Nos. 636, *et seq.* rulemaking proceeding,[1] a natural gas pipeline company should be required to continue firm transportation service for an existing shipper who has matched the highest competitive rate and term bid for such service, even though the rate is less than the highest permissible maximum rate established by FERC (maximum rate). This situation arises where the demand for pipeline capacity is less than the supply, which is the case in the nation's largest natural gas market, California, and which may also occur in midwest and northeast markets in the near term.

An illustration best serves to explain the point before the Court (hereinafter the Example). Assume the following facts:

Maximum rate	$.30/MMBtu
Existing shipper's current rate	$.10/MMBtu
Highest rate bid and matched by an existing shipper per ROFR	$.15/MMBtu

Burlington Resources maintains that an existing shipper should be able to retain its service by paying $.15/MMBtu, but FERC asserts the pipeline company can terminate service entirely unless the existing shipper agrees to pay $.30/MMBtu. This has been termed the "no discounting rule", because the pipeline

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[1] Order No. 636, FERC Statutes and Regulations 30,939 (1992); Order No. 636-A, FERC Statutes and Regulations 30,950 (1992); *Pipeline Service Obligations, and Revisions to Regulations Governing Self-Implementing Transportations Under Part 284 of the Commission's Regulations and Regulations of Natural Gas Pipelines After Partial Wellhead Decontrol,* Order No. 636-B, 61 FERC ¶ 61,272 (1992).

company is not obligated to discount below the maximum rate. FERC Brief at 8.

I. FORCING AN EXISTING SHIPPER UNDER THE ROFR MECHANISM TO PAY THE MAXIMUM RATE IS AN ANTI-COMPETITIVE EXERCISE OF MONOPOLY POWER AND A DENIAL OF SECTION 7(b) CONSUMER PROTECTIONS.

There is no dispute that the Natural Gas Act (NGA), 15 U.S.C. §§ 717, *et seq.*, was intended to provide consumers with the lowest reasonable rates and with continuity of service. Moreover, the enhancement of competition was at the heart of FERC's issuance of Order Nos. 636, *et seq.*[2] However, FERC's no discounting rule violates these precepts by forcing an existing shipper either to give up its firm service rights or pay a rate that is above-market.

This is a *prima facie* case of anti-competitive behavior and abuse of market power. Nevertheless, FERC defends its no discounting rule by asserting that even if the maximum rate is above-market, pipeline customers cannot be harmed by paying a FERC established maximum rate. FERC Brief at 21-2. Besides the substantial harm to existing shippers illustrated in the Example, FERC's argument fails on several other grounds.

First, FERC's reasoning completely contradicts the stated purpose of the ROFR mechanism, which is that price and term competition will determine which party gets pipeline capacity.[3] *See e.g.,* FERC's description of the ROFR as a

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[2] *See e.g.,* Pet. App. 178a-182a. FERC summarized its mission as follows:

> The Commission's primary aim in adopting the instant regulations is to improve the competitive structure of the natural gas industry and at the same time maintain an adequate and reliable service.

Id. at 181a.

[3] FERC claimed in Order Nos. 636, *et seq.* that the ROFR procedure would: (i) allow "the rate to play a role in rationing capacity . . . ." (Pet. App. 323a);

(footnote continues)

> process allowing competitive allocation of capacity at the expiration of long-term contracts for pipeline transportation...

FERC Brief at 6.

> [P]ipeline transportation is most efficiently allocated if it is sold to those willing to pay the highest price for the capacity.

Id. at 7.

But competition does not serve to allocate capacity where supply exceeds demand, because FERC lets the pipeline company disregard the competitive, market-determined outcome and instead force an existing shipper to pay an above-market rate or lose its service rights (*see e.g.*, the Example, *supra*). Thus, those without market power are left to be exploited by the wielder of market power, the pipeline company, and forced to pay a rate that could not be charged in a competitive environment.[4] This is a result which is patently anti-competitive and thus impermissible under the NGA.

Second, FERC seeks to support the no discounting rule by reference to this Court's decision in *Mobil Oil Exploration & Producing Southeast, Inc. v. United Distribution Companies,* 498 U.S. 211 (1991), which FERC characterizes as approving a "similar pricing mechanism". FERC Brief at 21. Although both cases involve pregranted abandonment, the comparison is not appropriate, since the orders under review in *Mobil* gave both

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(footnote continued)

(ii) "recognize the role of market forces in determining contract price and term" (Pet. App. 675a); and (iii) permit "the market to determine contract terms" and allow "market forces to play a significant role in determining the contract price . . . ." Pet. App. 933a.

[4] *See e.g., Jefferson Parish Hosp. Dist. No. 2 v. Hyde,* 466 U.S. 2, 27 n.46 (1984), where this Court defined market power to exist "whenever prices can be raised above the levels that would be charged in a competitive market."

parties negotiating leverage.[5] Thus, the Good Faith Negotiation procedure at issue in *Mobil* did not allow one side to inflict unilaterally the maximum rate on the other party.[6] This is not true of FERC's ROFR mechanism, where the no discounting rule permits the pipeline company to impose the maximum rate on the existing shipper or terminate that shipper's current transportation service.

Third, FERC tries to justify sanctioning monopolistic pricing practices by arguing that it cannot compel the pipeline company to charge less than the maximum rate, because the pipeline company might not recover its allocated cost of service. FERC asserts it "cannot require a pipeline to accept rates below the cost-based just and reasonable ceiling . . .", and that the maximum rate is, "by definition, the lowest rates that ensure pipelines an adequate return on their investment . . . ."[7] FERC Brief at 22.

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[5] These orders entailed the pregranted abandonment of producer sales to pipelines at "old" gas prices. In return for agreeing to pay a higher price, the pipeline was free to negotiate the reduction or elimination of its take-or-pay obligations to that producer. If, however, the parties could not agree on terms, the producer either continued service at the existing prices or found another buyer willing to pay the requested price. 498 U.S. at 219-20, 231.

[6] The Court stated in Mobil, 498 U.S. at 226, "There is nothing incompatible between the belief that a price is reasonable and the belief that it ought not be imposed without prior negotiations."

[7] FERC never offered this explanation in Order Nos. 636, *et seq.*, probably because FERC is well aware there is no mathematical relationship between the rate set and a pipeline company's actual revenues. As FERC knows, once rates are set, a pipeline company can reduce its costs of operation, increase throughput, sell more firm and interruptible services, or take other steps which will result in increased profits not contemplated at the time of the rate orders. *See* Burlington Resources Petition at 16.

Moreover, FERC's position assumes cost-based ratemaking, however FERC itself is experimenting with non-cost-based ratemaking. *See e.g., Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines and Regulation of Negotiated Transportation Services of Natural Gas Pipelines, Statement of Policy and Request for Comments,* 74 FERC 61,076 (1996).

This logic is fatally circular and internally inconsistent. On the one hand, FERC argues it cannot compel a pipeline company to accept a below maximum rate bid under the ROFR mechanism, because that might imperil the ability of the pipeline company to recover its full cost of service. Yet, if the pipeline company leaves capacity idle rather than sell it at less than the maximum rate under the ROFR procedure,

> there is no guarantee that it will be able to recover all the costs of its underutilized capacity from its customers when it files its next rate case.

Pet. App. 936a, footnote omitted.[8] Other than the timing of FERC's action, the result is the same, the pipeline does not recover the full cost of its capacity by virtue of a FERC decision.

FERC offers no explanation why what it allegedly "cannot" do as part of the ROFR mechanism, it is free to do in the context of a pipeline rate case. Moreover, FERC is wrong in claiming it lacks authority to require a pipeline company to accept less than the maximum rate under the ROFR mechanism. Such a requirement would merely be a condition of the ROFR mechanism, like the bidding and matching procedures, all of which were designed by FERC as a means to avoid the case-by-case abandonment criteria (including a hearing) required by Section 7(b) before an existing service can be terminated.

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[8] FERC also asserts an aggrieved shipper could file a complaint under NGA Section 5, 15 U.S.C. §717d, alleging the pipeline company's action is "unjust, unreasonable, unduly discriminatory, or preferential." FERC Brief at 21 n.13. Since this is an entirely new argument, it should not be entertained; *see* FERC Brief at 15, n.10. In any event, FERC action under Section 5 has prospective effect, which provides no remedy to an existing shipper who previously had to elect either to lose its firm service or pay a rate that is above market and/or higher than its existing contract rate.

In addition, FERC's argument fails because it overlooks the purpose of Section 7(b), which is to protect service continuity and not to guarantee revenues for pipeline companies.[9] Moreover, if existing shippers who supposedly are protected by Section 7(b) can be made to pay the maximum rate regardless of their existing contract rate or how the market values pipeline capacity, new shippers—particularly captive shippers—will be completely at the mercy of the pipeline company, even where the supply of capacity exceeds the demand.

Forcing a utility customer to pay an above-market rate is an exercise of monopoly power, whether the imposed rate is FERC approved or not. FERC cites no relevant precedent to the contrary, nor does FERC succeed in justifying the anti-competitive effect and lack of customer protection inherent in the no discounting rule.[10]

In the Example noted above, the maximum rate, the existing contract rate, and the lower ROFR bid rate all are cost-based, just and reasonable, and FERC approved. Thus, the dispute before the Court, simply stated, is whether Section 7(b) should be interpreted to insure the revenues of the pipeline company, as FERC asserts, or to protect the right of an existing shipper to service continuity and reasonable rates, as Burlington Resources argues. Given that the fundamental purpose of the NGA is to protect consumers against the monopolistic practices of pipeline companies, Burlington Resources should prevail.

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[9] This Court has found the NGA to be a consumer protection statute on numerous occasions, both as to rates and continuity of service. *See* the cases cited, Burlington Resources Petition at 8-9.

[10] FERC is obligated to consider anti-trust considerations in its deliberations. *See e.g., Gulf States Utilities Co. v. FPC,* 411 U.S. 747 (1973).

II. PRESERVATION OF THE NO DISCOUNTING RULE IS INCONSISTENT WITH FERC'S ORDER ON REMAND FROM THE DISTRICT OF COLUMBIA CIRCUIT DECISION.

The ROFR mechanism has two essential elements, the rate and the term of years bid, which the existing shipper must match in order to retain its service rights. The term of years included in Order Nos. 636, *et seq.* was a 20-year maximum, but this was remanded by the court below for further explanation. Pet. App. 53a. As noted in the FERC Brief, at 8 n.6, on remand FERC issued an order February 27, 1997 adopting a 5-year maximum contract term for ROFR purposes.[11] Burlington Resources concurs in this decision, but the change to a 5-year term fatally undermines FERC's insistence herein on the no discounting rule.

FERC's rationale for the switch from a 20-year to a 5-year contract term is that the reduced period reflects: (i) the need to recognize market forces in implementing the ROFR mechanism, [12] (ii) the need to overcome a pipeline's natural monopoly power,[13] (iii) acknowledgment of current contracting practices,[14] and (iv) the importance of not locking shippers into

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[11] Order No. 636-C, 78 FERC 61,186 (1997).

[12] Order No. 636-C, 78 FERC at 61,773.

> The right-of-first-refusal mechanism was, and is, intended to protect existing customers and provide them with the right of continued service, while at the same time recognizing the role of market forces in determining price and term.

[13] [T]he cap should protect captive customers from having to match competing bids that offer longer terms than the competing bidder would have bid "in a competitive market without pipelines' natural monopoly."

Id., footnote omitted.

[14] *Id.* at 61,774. "[T]he current data lead us to conclude that the term must be significantly shorter than the twenty-year cap approved in Order No. 636."

long-term contract arrangements they do not want.[15] If these same factors relied on by FERC with respect to the term element of the ROFR mechanism were applied with equal force to the rate element, the no discounting rule would be overturned.

Since the original 20-year ROFR term has been judged by FERC to be excessive because it condemns pipeline customers to the abuses of monopoly power, the same logic dictates existing shippers should not be forced to pay an above-market rate. Moreover, shortening the maximum contract term to five years from twenty years dramatically reduces the pipeline company's exposure to possible cost underrecovery if the pipeline company were required to accept the highest rate bid and matched (but less than the maximum) in the ROFR process, as Burlington Resources advocates.[16]

The need to coordinate the rate and term aspect of the ROFR mechanism is particularly acute as a result of the changes wrought by Order Nos. 636, *et seq.,* since pipeline companies are not obligated to file rate cases at a time certain, and they increasingly enter into long-term rate settlements, sometimes of up to ten years.[17] These circumstances effectively isolate the pipeline company from rate scrutiny for extended periods, thereby lessening into nothingness FERC's argument that a pipeline company might suffer in its next rate case for deliberately idled capacity.

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[15] FERC concluded its 5-year contract term would "avoid customers' being locked into long-term arrangements with pipelines that they do not really want . . . ." Id.

[16] The reverse, however, is not true, because no utility customer should have to pay an excessive, monopoly initiated rate for any period. Moreover, shortening the contract term does not eliminate the exercise of pipeline monopoly power, and reducing the contract term without eliminating the no discounting rule merely condemns a long-term customer to agreeing to excessive rates at more frequent intervals.

[17] Several pipelines have entered into 5-10 year rate settlements which address the treatment of idled capacity. *See e.g., El Paso Natural Gas Co.,* 79 FERC ¶ 61,028 (1997); *Tennessee Gas Pipeline Co.,* 77 FERC ¶ 61,083 (1996); *Transwestern Pipeline Co.,* 72 FERC ¶ 61,085 (1995).

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

KIM M. CLARK
Counsel of Record
JOHN, HENGERER
& ESPOSITO
1200 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 429-8800

RICHARD M.
BLUMBERG
Associate General
Counsel
BURLINGTON
RESOURCES OIL &
GAS COMPANY
5051 Westheimer
Suite 1400
Houston, Texas 77056
(713) 624-9270

Attorneys for Petitioner